European Association of Co-operative Banks
Groupement Européen des Banques Coopératives
Europäische Vereinigung der Genossenschaftsbanken

EACB answer to the CESR consultation paper on the transparency of corporate bond, structured finance product and credit derivatives markets

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The **European Association of Co-operative Banks** (EACB) is the voice of the co-operative banks in Europe. It represents, promotes and defends the common interests of its 28 member institutions and of co-operative banks in general. Co-operative banks form decentralised networks which are subject to banking as well as co-operative legislation. Democracy, transparency and proximity are the three key characteristics of the co-operative banks' business model. With 4.200 locally operating banks and 63.000 outlets co-operative banks are widely represented throughout the enlarged European Union, playing a major role in the financial and economic system. They have a long tradition in serving 160 million customers, mainly consumers, retailers and communities. The co-operative banks in Europe represent 50 million members and 750.000 employees and have a total average market share of about 20%.

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General remarks

1. The EACB welcomes the opportunity to actively contribute to the CESR consultation on transparency obligations for corporate bonds, structured finance products and credit derivatives markets.

2. The background of discussions around transparency obligations is Art. 65 of MiFID in which a possible extension of the scope of the provisions of MiFID is mentioned. Such an extension is related to pre and post-trade transparency obligations to transactions in classes of financial instruments other than shares.

   In a report published in April 2008 the European Commission underlined that it does not see the necessity of extending the scope of the transparency obligations. EACB totally agrees with the opinion of the Commission on this matter and is against the extension of the transparency obligations.

PART I: Corporate Bonds

3. From our perspective we consider a pre- and post-trade transparency in non-equity markets for corporate bonds as not necessary. We do not have any information that an absence of transparency obligation from competent authorities would lead to deficits in the market efficiency.

4. We would like to point out that there are already different market based sources that enable a price transparency. Numerous electronic platforms offer a wide range of post trade services and possibilities for pre trade analysis. Those information enable an investor to compare prices and other information in a transparent way.

   Regulatory initiatives on this matter would jeopardize these flexible initiatives from the market itself.

Q1: Do you believe the situation described above may be symptomatic of a market failure?

5. As highlighted in graph 2 on page 12 the markets for non-financial names and for financial names have developed in the same way. Those developments show that the market is functioning. The reactions visible in the graph are comprehensible and proof that there was no market failure.

Q2: Have you perceived a potential asymmetry of information between market participants?

6. We agree with CESR that a lack of transparency linked to composition, arrangement and impact of certain financial instruments was a catalyst for the crisis. However we consider the extension of trade transparency requirements as improper to resolve this deficit. Post-trade transparency only reduces the symptoms but does not have any impact on the roots of the problems.

Q3: In your view, what were the key reasons which have led to sharply reduced liquidity in secondary trading of European corporate bonds since 2007?

7. From our perspective the perceived reduction of liquidity in secondary trading is not caused by a lack of transparency, but by a significant decline of all fundamentals as well as a general loss of confidence in the course of the crisis. In addition the downgrading of major issuers by rating agencies, the escape of many investors in government bonds and the recession in most of the relevant markets had certainly a negative impact on the secondary trading of European corporate bonds. We certainly do not welcome such a development, but consider it as a healthy market behavior. More transparency would not have had a positive influence on those developments.

Q4: Do you believe that additional post

8. As already outlined in 3) we do not believe that additional post-trade transparency would have helped maintain liquidity in stressed market conditions.

Q5: In your view, what were the key reasons for the widening of the bid/offer spreads for European corporate bonds?

9. The spread is a sign for the risk that market maker are willing to take. In case of an aggravation of the fundamentals of an issuer, the market maker will take this fact into consideration when setting the price, in order to minimize the risk. At the same time the general reduction of liquidity causes a widening of bid and offer spreads.

Q6: Do you believe that greater post-trade transparency would have been helpful in limiting the widening of the bid/offer spreads we have observed for European corporate bonds?

10. We do not think that more transparency would have had an influence on the widening of the bid/offer spreads. As highlighted in 9) we consider it as a reaction to higher risks.

Q7: Do you use CDS prices for pricing European corporate cash bonds? If so, what are the key benefits?

11. As an association we do not have own experience in pricing.

Q8: Which methods of bond price valuation do you use in the current market turmoil? Do you think that the CDS market is still a reliable indicator for bond price valuation?

12. As an association we do not have own experience in pricing.

Q9: The spreads between the CDS and corporate cash bonds have widened significantly in the first quarter of 2008. Did this widening of the spreads make it more difficult to price European corporate bonds? If so, do you think that additional post-trade transparency of corporate bond prices would have helped you to price European corporate bonds? How do you assess the situation since mid-September 2008?

13. As an association we do not have own experience in pricing.

Q10: Do you expect that the relationship between the CDS market and the cash bonds market will return to what has been observed historically once market conditions stabilize? If not, can you please articulate the reasons?

14. We expect a normalization of the relationship between the CDS market and the cash bonds market once the market conditions are stable again.

Q11: Have you experienced difficulties in valuing corporate bond holdings? If so, what were the main reasons?

15. As an association we do not have own experience in pricing.

Q12: Would additional post-trade trade transparency in distressed market conditions help valuation?

16. In distressed markets both IFRS and US GAAP require adequate pricing models based on the expected cash flows for the price valuation. The concrete choice and calibration of those models is up to the companies. Prices of single, individually agreed transactions are not an adequate reference for a valuation.

Q13: Do you agree with the potential benefits and drawbacks described above? Please provide evidence supporting your opinion. Please explain how the potential drawbacks might be mitigated.

17. We would like to point out that it is not true, that retail investors do not have access to market data. E.g. ICMA provides data for numerous bonds. In addition a retail investor can contact his/her bank for information on the current price.

    We do agree with the CESR outlines in paragraph 55 that state that post trade transparency obligation has a negative impact on the liquidity because it would reduce incentives on liquidity providers to participate in corporate bond markets.

    We furthermore agree with CESR's views in paragraph 56. There is the jeopardy of herding behavior by investors in distressed market conditions. Furthermore we also share CESR's concern of a possible decline in trading volume – as highlighted by CESR in paragraph 57.

    We disagree with CESR's assessment made in paragraph 58. The trading of bonds at stock exchanges or MTFs is very transparent. Already today banks have all required information.

    In relation to paragraph 59 we would like to highlight that reliable conclusions can only be made after a detailed evaluation of statistical data.

Q14: Are there other main benefits or drawbacks of increased post-trade transparency in the bond markets which CESR needs to consider?

18. Please see out outlines in the general remarks.

Q15: What are your personal experiences with TRACE? Please specify whether you are directly trading in the US corporate bond markets on the buy or sell side.

19. We do not have any information on this matter.

Q16: Do you see other benefits or drawbacks of the introduction of a TRACE-like post-trade transparency regime for OTC trades in corporate bonds in Europe?

20. We would like to point out that we are against an extension of transparency obligations to corporate bonds. Such an obligation would lead to various drawbacks that we outlined in the previous answers.

    In respect with the US-system TRACE we would like to highlight that there is no clear assessment of it yet. There are voices both in favor and against it which leads to an ambivalent picture.

    From our perspective there is the need of a clear market failure before thinking about regulatory initiatives. In addition every initiative must withstand an intense cost benefit analysis. We furthermore do not think that experiences made in the US market are transferable to the European Union. For instance in the US there were – before implementing TRACE – wide bid-ask-spreads diffused, which is not the case in the European markets.

Q17: Are you of the view that the more notable volume declines experienced for 144a securities, compared to securities which are covered by TRACE, is due to a lack of post-trade information? Please provide a rationale.

21. We do not have information on this matter.

Q18: Please provide information on your experience, if any, in terms of timing, content and access to information of the market-led solutions outlined above. What is your assessment of the effectiveness of the present self-regulatory initiatives?

22. We do consider neither obligatory nor voluntary information to OTC trading as necessary. In relation to the initiatives of ICMA and SIFMA we would like to highlight that those are focused on retail investors. Retail clients invest only rarely in corporate bonds and if so they normally have a buy-and-hold strategy. They do not have the aim of trading. Therefore we do not see the need of extending transparency obligations.

    We would like to highlight that retail clients are already – also in case of corporate bonds – broadly protected by the rules of the MiFID.

Q19: Please provide comments on the characteristics that market-led initiatives should, in your view, have.

23. As outlined in 18) we do not see the necessity for obligatory or voluntary transparency rules.

Q20: Do you think that the introduction of additional post-trade information on prices could help restore market confidence and maintain market liquidity in times of future crisis?

24. We do not see a market failure on this matter. Therefore we do not think that more market transparency would lead to an increased market confidence. The reason for the stressed markets is based on the economic situation in all European markets as well as on a negative development of the fundamentals of many companies.

Q21: Do you believe that additional post-trade transparency of European corporate bond markets would contribute to liquidity in normal market conditions? Can you please explain why?

25. There is already enough information available in the markets that can be used for pricing.

Q23: What would be the benefits and the downsides of a harmonised pan-European transparency regime for: a) the wholesale market; b) the retail market.

26. For both wholesale and retail markets we do not see any benefit of a pan-European transparency regime.

Q24: Is the reduced reliability of the CDS market as an indicator/proxy for calculating the value/price in the cash market under certain market conditions an issue which calls for more post-trade transparency of cash corporate bonds?

27. The CDS market has proven its integrity in the crisis. Especially instruments that enable a market participant to hedge its risks have served their purpose.

Q25: Do you think that transparency requirements could help address wider issues such as those relating to accurate valuations?

28. No, from our perspective additional transparency obligations for accurate valuations are not necessary.

Q26: What would be the most cost-effective way of delivering additional transparency an industry-led solution, possibly based on a road map set by regulators, or mandatory regulatory post-trade transparency requirements? a) the retail market. b) the wholesale market; Please, provide a rationale.

29. As already outlined we do not see any market failure on this matter and therefore not the need for any transparency obligations and/or self regulatory rules.

Q27: Which should be in your view the key components of a post-trade transparency framework for corporate bonds? Please provide your view with respect to depth and breadth of information as well as to timeliness of data as described above.

30. We consider a transparence framework as not necessary.

Q28: Should the information on the volume be reported only below a certain size, what would be the threshold to avoid any risk of market impact?

31. We consider a transparence framework as not necessary.

Q29: Would you see some benefits in a step-by-step implementation, starting with the most liquid bonds, as employed when TRACE has been introduced?

32. We consider a transparence framework as not necessary.

PART II: Structured Finance Products and Credit Derivatives

33. All structured securities are individually developed and not standardized. Due to this individual structure a post trade publication of price information does not make sense. It is not possible to perfectly compare ABS securities since every single one differs from each other. The value of such information is therefore very limited.

34. We would like to highlight the difference between an asymmetry of information related to the composition of a financial product and a lack of information on prices traded in the market. We agree with CESR that the former has damaged the functioning of the market. However we would like to point out that more price transparency would not have avoided the crisis.

35. As a conclusion we are against an introduction of post trade transparency obligation for structured products and credit derivatives.

Contact:

The EACB trusts that its comments will be taken into account. For further information or questions on this paper, please contact:

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